

FISCAL NOTE

Bill #: SB0023

Title: Transfer % of old fund reserve attributable to state premiums to general fund

Primary Sponsor: Jim Elliot

Status: Grey Bill

Sponsor signature	Date	Chuck Swysgood, Budget Director	Date
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Fiscal Summary

	<u>FY 2003 Difference</u>	<u>FY 2004 Difference</u>	<u>FY 2005 Difference</u>
Expenditures:			
Federal Special Revenue			
Other - Enterprise	\$14,759,977	\$0	\$0
Revenue:			
General Fund	\$10,331,983	\$0	\$0
State Special Revenue	\$4,427,993		

Net Impact on General Fund Balance: Increases General Fund balance by \$10,331,983.

<u>Yes</u>	<u>No</u>		<u>Yes</u>	<u>No</u>	
	X	Significant Local Gov. Impact	X		Technical Concerns
	X	Included in the Executive Budget	X		Significant Long-Term Impacts
	X	Dedicated Revenue Form Attached	X		Family Impact Form Attached

Fiscal Analysis

ASSUMPTIONS:

1. SB 23 Grey Bill has a technical error creating an ambiguity on the amount to be transferred from the State Fund's (New Fund) unrestricted fund balance.
2. Despite the ambiguity this fiscal note is being written to provide data on the impact of the legislation as State Fund staff interprets the legislation.

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3. The FY 2003 transfer of the Old Fund FY 2002 excess of 'adequate funding' is estimated to be \$8,403,348.
4. SB 23 Grey Bill requires transfer of the Old Fund FY 2002 excess of adequate funding to the State Fund following completion of audited financial statements and prior to June 30, 2003.
5. Based on the Montana State Fund's FY 2002 un-audited statutory financial statements, the total amount of unrestricted fund balance estimated to be in the account established in MCA § 39-71-2321 (State Fund – New Fund) is \$158,000,000.
6. The estimated unrestricted fund balance may be impacted by the audit of financial statements.
7. The estimate of unrestricted fund balance is prior to the independent actuary's analysis of State Fund (New Fund) claim reserves and the actual results of the independent actuary's analysis may impact unrestricted fund balance.
8. The total State Fund (New Fund) unrestricted fund balance upon which the transfer to the general fund and the State Special Revenue will be based is estimated to be \$166,403,348 (FY 2002 estimated State Fund (New Fund)) unrestricted fund balance \$158,000,000 plus FY 2002 Old Fund excess surplus transfer of \$8,403,348).
9. SB 23 Grey Bill requires transfer of 8.87% of the State Fund fund balance to the general fund and State Special Revenue.
10. The total estimated transfer from the State Fund (New Fund) to the general fund and State Special Revenue is \$14,759,977. It is the intent of this bill that 70% of the total transfer will go to the general fund (\$10,331,983) and 30% to State Special Revenue (\$4,427,993).
11. The general fund portion will be added to DPHHS for FY 2003, partially restoring original cuts.
12. The workers' compensation old fund balance could be interpreted as a rebate of premiums. When the premiums were paid, the federal government participated in premium costs. There is a contingent liability if the federal government were to interpret this is a premium rebate. If this were to occur, the federal government would want a share of the premiums returned. The current federal participation is calculated at 20 percent plus interest. The State Special Revenue account will be used by the Department of Administration to pay the costs of any federal liability for premium rebates.
13. SB 23 reserves monies in FY 2004 and beyond for basic and per-ANB entitlements for K-12 public schools. These monies will not be available to schools until the monies are appropriated by the Legislature.
14. Under existing law, all property and securities acquired through the use of money belonging to the state fund, and interest and dividends are the sole property of the state fund and must be used exclusively for the operations and obligations of the state fund. The money collected by the state fund may not be used for any other purpose (MCA § 39-71-2320). The money coming into the state fund must be held in trust for the purpose for which the money was collected (MCA § 39-71-2322). Attempts to divert the assets of the State Fund, whose assets are to be used only for State Fund purposes, may amount to an unconstitutional impairment of the State Fund's policyholders' contracts with the State Fund, or an unlawful use of funds held in trust for State Fund purposes. See *Eckles v. State of Oregon*, 306 Ore. 380, 760 P. 2d 846 (1988); *Gronning v. Smart*, 561 P.2d 690 (Utah 1977); *Moran v. Oklahoma*, 534 P.2d 1282 (Ok. 1975).
15. Under existing law, MCA § 39-71-2330, the State Fund is required to amass and maintain an excess of surplus over the amount produced by the National Association of Insurance Commissioners' risk-based capital requirements for a casualty insurer. The surplus above the risk-based capital requirements are to secure the State Fund against various risk inherent in or affecting the business of insurance.
16. Surplus is intended to assure that the insurer will be able to fulfill its obligations to policyholders and injured employees. Premiums are established before the number, severity, duration, or cost of claims can

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be known. Case reserves and actuarial reserves are established as claims occur, but the ultimate cost of those claims is not known for many years. Catastrophic and unanticipated events may occur; this possibility cannot be fully funded in each year's premiums. Assets held in support of the obligations vary in value over time.

17. Surplus based on sound industry standards is necessary to stabilize costs to business and foster regional economic competitiveness for Montana employers.
18. Montana State Fund (MSF), as a workers' compensation state fund, has several characteristics that highlight the importance of surplus to absorb adverse scenarios:
 - a) Extremely long-term obligations associated with workers' compensation claims;
 - b) MSF writes one line of insurance (increases volatility of results);
 - c) MSF writes in a single state (increases volatility of results);
 - d) MSF provides a guaranteed market (increases volatility of results); and,
 - e) Unlike a stockholder-owned insurance company, MSF cannot access additional capital to finance future growth or to cover adverse financial results – MSF's surplus must be adequate not only to cover current and next year's obligations, but also support the long-term strategy.
 - f) Montana State Fund needs stronger than average surplus to address these issues.
19. Due to statutory requirements on surplus the State Fund will be required to increase premiums charged to policyholders to offset the \$14,759,977 transfer to the general fund.
20. The State Fund will increase rates for the next full rate year period and the contributions to State Fund surplus will occur in FY 2004 and FY 2005.
21. The estimated average increase to premiums charged is approximately 18% to rebuild surplus in one rate year period.
22. A price shock of this magnitude is expected to result in premium retention decreasing to 85% or less. Retention would be lower to the extent that private carriers re-enter the Montana market. Loss of market share would be primarily in the large account segment.
23. Risk quality of retained accounts would deteriorate. Expected loss ratios at 'on-level' manual premium would rise at least three and a half points. The reduced risk quality would result in net debits for tiered and experienced rating programs.
24. Expense structure would not materially change.
25. Credits would substantially rise in order to retain good risk as much as possible.
26. The State Fund payment of dividends would be discontinued until such time as the State Fund Board of Directors, after consultation with the independent actuary, determines that excess surplus can be safely refunded to policyholders.
27. The State Fund will lose an estimated \$885,600 in investment income per year based on an average annual rate of return of 6% on the funds transferred to the general fund.
28. SB 23 (Grey Bill) removes the requirement that the State Fund return transferred funds to the Old Fund should the Old Fund be determined to have less than 'adequate funding'.
29. SB 23 (Grey Bill) requires the general fund to transfer funds to the Old Fund if the Old Fund is not 'adequately funded'.

FISCAL IMPACT:

	FY2003 <u>Difference</u>	FY2004 <u>Difference</u>	FY2005 <u>Difference</u>
<u>Expenditures:</u>			
Transfers	14,759,977	0	0

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Funding:

General Fund (01)	\$14,759,977	\$0	\$0
Other – Enterprise (06)	(\$14,759,977)	\$0	\$0

Net Impact to Fund Balance (Revenue minus Expenditure):

General Fund (01)	\$14,759,977	\$0	\$0
Other – Enterprise (06)	(\$14,759,977)	\$0	\$0

TECHNICAL NOTES:

1. Subsection 5(C) requires a transfer of ‘30% of the total amount of the unrestricted fund balance’ to be transferred to a State Special Review account. This amount would be approximately \$45.5 million after the general fund transfer of \$14.76 million, for total transfers from the State Fund of \$60.25 million.
2. This creates an ambiguity however State Fund staff has interpreted 39-71-2352(5)(b) as controlling 39-71-2352(5)(c), to transfer 8.87% of the State Fund (New Fund) unrestricted fund balance (\$14.76 million). Of this amount 70% or \$10.3 million will go to the general fund and 30% or \$4.43 million will go to State Special Revenue.
3. Title requires immediate transfer of Old Fund’s excess of adequate funding and bill language does not require immediate transfer.